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IN THE

Supreme Court of the United States

OCTOBER TERM, 1959.

No. 588

LESLIE J. VALLESKEY AND GRACE VALLESKEY,
Petitioners,

vs.

E. J. NELSON, DISTRICT DIRECTOR OF INTERNAL REVENUE,
Defendant.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

LESLIE J. VALLESKEY and
GRACE VALLESKEY,
709 Franklin Street,
Manitowoc, Wisconsin,
Pro Se.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

Leslie J. Valleskey and Grace Valleskey, Petitioners herein, respectfully petitioning, show the Court:

I.

OPINIONS BELOW.

The opinion of the United States Court of Appeals for the Seventh Circuit is not yet printed in the report and is therefore printed in the appendix to this petition at pages 11 *et seq.* The opinion of the United States District Court for the Eastern District of Wisconsin is reported at 168 Fed. Sup., page 636 and also printed in the appendix to this petition at pages 15 *et seq.*

II.

JURISDICTION.

The judgment of the Court of Appeals for the Seventh Circuit was dated and entered October 22, 1959. Stay of Mandate was granted November 3, 1959. Jurisdiction of this Court is invoked under Title 128, United States Code, Sec. 1254(1).

III.

QUESTIONS PRESENTED.

A testamentary provision read as follows:

> "I hereby authorize by executors hereinafter named to sell my home located at 1026 South 15th Street, Manitowoc, Wisconsin to Leslie J. Valleskey for the assessed valuation thereof as of 1950, if he desires to purchase the same for that amount."

After testatrix' death Leslie J. Valleskey acquired said home from the executor, after paying $4,800.00, the assessed valuation. A short time later he sold said home for $10,000.00. At time of death of testatrix, home was appraised at $10,250.00.

(a) Is petitioner's capital-gain-or-loss-basis $4,800.00, the amount paid, or $10,250.00, the fair market value at the time of the death of testatrix?

(b) Did petitioner acquire the property in question by devise or bequest, or by purchase?

(c) Did the above testamentary provision give a power of appointment to the executor, the exercise of which related back to the death of testatrix or did it give an option to petitioner?

IV.

STATUTES INVOLVED.

Sec. 113 of the 1939 Internal Revenue Code reads partly as follows:

"ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) Basis (Unadjusted) of Property.—The basis of property shall be the cost of such property; except that—

* * * * *"

(5) Property transmitted at death.—If the property was acquired by bequest, devise or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition * * *"

Sec. 232.05 Wisconsin Statutes reads as follows:

"General Power: A power is general when it authorizes the alienation in fee by means of a conveyance, will, or charge of the lands embraced in the power, to any alienee whatever."

Sec. 232.06 Wisconsin Statutes reads as follows:

"Special Power. A power is special:

(1) When the person or class of persons to whom the disposition of the lands under the power to be made are designated.

(2) When the power authorizes the alienation by means of a conveyance, will or charge of a particular estate or interest less than a fee."

Sec. 232.22 Wisconsin Statutes reads as follows:

"Special Powers in Trust. A special power is in trust:

(1) When the disposition which it authorizes is limited to be made to any particular person other than the grantee of such power."

(2) When any person or class of persons, other than the grantee, is entitled to any benefit from the disposition or charge authorized by the power."

Sec. 232.25 Wisconsin Statutes reads as follows:

"Trust Powers Imperative. Every trust power, unless its execution or non-execution is made expressly to depend on the will of the grantee, is imperative and imposes a duty on the grantee the performance of which may be compelled by action for the benefit of the parties interest."

V.

STATEMENT OF THE CASE.

Petitioners sued the District Director of Internal Revenue in the U. S. District Court for the Eastern District of Wisconsin for the recovery of income taxes illegally and erroneously determined and collected.

The following facts were stipulated:

(1) That plaintiffs are husband and wife and filed a joint income tax return for the year 1953; that plaintiff Leslie J. Valleskey, was the attorney for one Meta Michelson for a number of years; that she died March 15, 1953; that item 38 of her will is as follows:

"I hereby authorize my executors hereinafter named to sell my home located at 1026 South 15th Street, Manitowoc, Wisconsin, to Leslie J. Valleskey for the assessed valuation thereof as of 1950, if he desires to purchase the same for that amount."

That the 1950 assessed valuation of the real estate referred to in item 38 above was $4,800.00; that said property was appraised in her estate at $10,250.00, which figure was used in the federal estate and state inheritance tax computations; that pursuant to the Will, the East Wisconsin Trustee Co., as executor, paid the sum of $620.98 inher-

itance tax on item 38 in the Will; that thereafter and on June 1, 1953, Leslie J. Valleskey sold that real estate for the sum of $10,000.00, he having theretofore obtained the property for the sum of $4,800.00 pursuant to item 38 in the Will. That the basis used was $10,290.00, consisting of the appraised value of $10,250.00 plus certain selling costs incurred in the amount of $40.00. The ultimate effect of using this as a basis resulted in a short-term capital loss of $290.00 and that was claimed by plaintiffs in their federal return for 1953. Thereafter the government concluded that the basis to be used was $4,840.00, consisting of $4,800.00, which plaintiff, Mr. Valleskey, paid for the property plus $40.00, selling costs, resulting in a short term capital gain of $5,160.00, and on that alleged short-term capital gain made a deficiency assessment of $2,730.05, which plaintiffs paid, together with interest in the amount of $529.25; that plaintiffs made proper claim for refund which was refused and which was not acted upon and that plaintiffs brought this action within the time required by law.

(2) It is further stipulated that the plaintiff, Leslie J. Valleskey, was named as co-executor by the testatrix in her Will, that he refused to accept the position of co-executor, that the East Wisconsin Trustee Co. became the sole executor, and that said executor retained plaintiff, Leslie J. Valleskey, as its attorney in connection with the probate of the estate.

VI.

ARGUMENT.

1. Conflict in the Circuits—Double Taxation.

It is petitioners' position that item 38 of the Michelson Will constituted a contingent testamentary gift, operative through a power of appointment, which gift was, by bequest, devise or inheritance, acquired directly from the testatrix. From this petitioners argued that Sec. 113(a)(5) of the 1939 Internal Revenue Code applied. It was petitioners' contention that the power of appointment involved was a discretionary power. The Courts below, however, found that this power of appointment was mandatory.

Whether we are dealing here with a mandatory power or a discretionary power of appointment, the fact remains that the exercise of this power constitutes the event upon which the final vesting of the legacy is conditioned.

This brings us to the conflict in the circuits.

Augustus v. *C. I. R.*, 118 Fed. 2d 38 (C. C. A. 6) disclosed the following facts:

Father established a testamentary trust which gave wife the right to income, to consume corpus and to dispose by will of one-half of corpus. Father died in 1922, wife in 1928, without having exercised the power to consume principal or to dispose of it by will. Upon mother's death the trust was terminated and corpus distributed to daughters. Daughters in 1935 and 1936 sold certain securities belonging originally to the trust. The question arose whether for capital gain and loss purposes daughters acquired securities as residuary legatees under father's will in 1922 or through mother's death in 1928. The Board of Tax

Appeals held that the daughters acquired securities through father's will in 1922, which decision was affirmed by the Circuit Court of Appeals.

This case involved an acquisition through a contingent testamentary gift. Had mother consumed the corpus of the trust, daughters would have gotten nothing. Had mother exercised her power of appointment by willing one-half of the corpus to a third person, daughter would have gotten only one-half.

The taxpayers in the *Augustus* case argued that Section 113(a)-5), establishing value at testator's death as basis applied only to vested and not to contingent remainders. The court, however, held that decedent's death was the time of acquisition and the death value the basis for all testamentary gifts whether vested or contingent, including those acquired through the non-exercise of a power of appointment.

The reasoning of the Circuit Court in the *Augustus* case is based on a comprehensive picture of the federal tax system and the relationship between income and estate taxes. In this connection the *Augustus* decision stated as follows:

> "It would certainly not be illogical or unnatural to consider a decedent's death the time when a beneficiary acquireds property from him, whatever its nature, though for taxation purposes there might be some practical reason for selection of some later date. In this connection it will be borne in mind that the value of the deceased's property at death is the basis upon which the estate tax is computed. *Whatever gain was realized between the deceased's acquisition of the property and his death is thereby made to bear its rightful share of the tax burden.*
>
> The increase in the value of the property, if any, after decedent's death, is taxable when realized and to him who realizes it." (Emphasis supplied.)

The estate tax levies on the appreciation of value of property which occurred before decedent's death. The income tax, under the correct interpretation of Sec. 113(a)(5) levies on the appreciation of value after decedent's death. If the appreciation before decedent's death should also be reached by the income tax we would have a case of double taxation. Double taxation is to be avoided unless expressly required by the Tax Act. *Burnett* v. *Whitehouse*, 38 F. 2d 162, affirmed, 51 S. Ct. 374, 283 U. S. 148, 75 L. Ed. 916.

As held in the *Augustus* case there is nothing in Sec. 113(a)(5) nor in the estate tax law to disclose an intent of Congress to impose double taxation.

There is no substantial difference between our facts and those in the *Augustus* case. In the *Augustus* case the final vesting of the estate could only take place if the life tenant did not consume the principal and if he did not exercise the testamentary power of appointment.

In our case the final vesting of the estate was postponed until the power of appointment was exercised. True, in the *Augustus* case the relation back of the vesting to the time of testator's death operated in favor of the government. In our case it would operate in favor of taxpayer. This result however, should not affect the basic law controlling both situations equally.

2. The Courts Below Decided an Important State Question in Conflict With Applicable State Law.

The government in our case took the position that item 38 of the Michelson Will was an option and as such not distinguishable from *Mack* v. *C. I. R.*, 148 F. 2d 62 (C. C. A. 3). It appears that the *Mack* case involved an undisputed testamentary option, a fact which never was denied by J. Gordon Mack, the taxpayer litigating this case. The per-

tinent provisions of the Mack will are reprinted on page 18 of the petition (Decision of District Court).

Petitioners however, very strongly denied that Item 38 of the Michelson Will involved a testamentary option. Petitioners argued that Item 38 created a special power of appointment in the executor. It is a well established principle that where a person takes by execution of a power, he takes under the authority of the power, as if the power and the instrument creating the power had been incorporated in one instrument. 41 Am. Jur. page 857. *In Re Will of Morgan*, 227 Wis. 288, 277 N. W. 650 it was held as follows:

> "It is no doubt true that under the common law an appointee takes title from the donor and not from the donee."

We accordingly argued that petitioner Leslie J. Valleskey in our case acquired the property by bequest, directly from Meta Michelson, through the exercise of a power of appointment by executor. This distinguishes our case from the *Mack* case where a testamentary option existed and where the taxpayer acquired the property from the testamentary trustee by purchase.

Petitioners based their argument, which distinguished the Michelson Will from the Mack Will on the different wording of both provisions.

Both lower Courts agreed that we were dealing with a special power of appointment. They held, however, that the power in question was a special power in trust and that its execution was mandatory upon the grantee pursuant to Section 232.23 Wisconsin Statutes.

We feel that the conclusions of the lower Courts were erroneous for the following reasons:

Petitioner Leslie J. Valleskey, the appointee (grantee) under the will was also named co-executor in the Will (he

declined the appointment as executor after Meta Michelson's death).

Since petitioner Leslie J. Valleskey was the grantee under a special power, such power could not be in trust pursuant to Section 232.22(1) Wisconsin Statutes. And if such power is not in trust, it cannot be imperative under Sec. 232.23 Wis. Stat.

Furthermore even if the trust power in our case should be imperative the relation back effect of such power should not be affected thereby.

We accordingly feel that the decisions of the Courts below are in conflict with the applicable law of the State of Wisconsin.

VII.

CONCLUSIONS

In times when the burden of taxation weighs heavily on the taxpayer it is necessary to support this burden by a logical system of taxation where each tax has its proper well defined area of operation and its function. If the government prevails in this case it would mean that we have areas overlapped by both estate and income taxes.

WHEREFORE petitioners pray that the Writ of Certiorari issue to the United States Court of Appeals for the Seventh Circuit to review its judgment in this case.

Respectfully submitted,

LESLIE J. VALLESKEY,
GRACE VALLESKEY,
Petitioners, pro

APPENDIX.

IN THE UNITED STATES COURT OF APPEALS

For the Seventh Circuit.

September Term, 1959—September Session, 1959.

No. 12647.

LESLIE J. VALLESKEY and GRACE VALLESKEY,
Plaintiffs-Appellants,
vs.
E. J. NELSON, DISTRICT DIRECTOR OF INTERNAL REVENUE,
Defendant-Appellee.

Appeal from the United States District Court for the Eastern District of Wisconsin.

October 22, 1959.

Before DUFFY, PARKINSON, and CASTLE, *Circuit Judges.*

CASTLE, *Circuit Judge.* This is an appeal from a decision by the District Court of the Eastern District of Wisconsin on motion of both parties for a summary judgment. The plaintiffs are husband and wife and filed a joint income tax return for the year 1953; the plaintiff, Leslie J. Valleskey,[1] was the attorney for one Michelson for a number of years prior to her death. She died March 15, 1953. Item 38 of her will was as follows:

"I hereby authorize my executors hereinafter named to sell my home, located at 1026 South 15th Street,

[1] Referred to as taxpayer

Manitowoc, Wisconsin, to Leslie J. Valleskey for the assessed valuation thereof as of 1950, if he desires to purchase the same for that amount."

The taxpayer and the East Wisconsin Trustee Company were appointed as co-executors under the will. Taxpayer declined to serve as co-executor although he did act as attorney for the executor throughout the estate proceedings.

The 1950 assessed valuation of the real estate referred to in the will was $4800.00; the appraised value of this property as listed in the estate was $10,250.00, which figure was used in the federal estate and state inheritance tax computations.

The East Wisconsin Trustee Company as executor paid the sum of $620.98 inheritance tax on Item 38 in the will. On June 1, 1953 Leslie J. Valleskey sold the said real estate for $10,000.00, he having previously paid the sum of $4800.00 for the property pursuant to Item 38 in the will.

The basis used by the taxpayer for computing gain or loss for income tax purposes was $10,250.00, plus $40.00 expenses incurred in the sale. The result of using this basis is a short-term capital loss of $290.00 which was claimed by the plaintiffs in their federal income tax return for 1953.

The Government contended that the basis to be used was $4840.00 consisting of the $4800.00 which the taxpayer paid for the property, plus $40.00 selling cost, which resulted in a short-term capital gain of $5,160.00 and made a deficiency assessment of $2,703.05, which the plaintiffs paid, together with interest in the amount of $529.25; the taxpayer made proper claim for refund which was refused and this action is brought to recover the aforesaid amount.

The contested issues are:

(a) Is the taxpayers' capital gain or loss based on $4800.00, the purchase price paid, or $10,250.00, the appraised value at the time of the testatrix's death?

(b) Did the taxpayer acquire the property in question by devise, or bequest or by purchase?

(c) Was the testamentary provision mandatory or was it discretionary on the executor?

The applicable statute is Section 113 of the Internal Revenue Code of 1939 which provides as follows:

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) Basis (unadjusted) of property. The basis of property shall be the cost of such property; except that—

(5) Property transmitted at death. If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition. • • •

(26 U. S. C. 1952 ed., Sec. 113.)

Item 38 of the will authorized the sale of the entire property at the 1950 assessed valuation and gave the taxpayer the right to purchase the property for that amount if he so desired.

There was no gift of any portion of the property itself to the taxpayer under the terms of the will.

The acquisition of the property was not by bequest, devise, or inheritance, so as to bring the transaction within the terms of Section 113(a) (5).

The language in Item 38 of the will which uses the phrases "to sell" and "to purchase" means nothing more than giving the taxpayer the right to purchase the property.

In *Mack* v. *Commissioner*, 3 Cir., 148 F. 2d 62 certiorari denied 326 U. S. 719, the taxpayer acquired under his

father's will an option to purchase a limited number of shares of stock from the testamentary trustee at a price equal to one-half of the average market value of the shares at the time of the exercise of the option. The taxpayer exercised the option, purchasing the stock at $34.06 per share. The average market price, as defined in the will, at the time of taxpayer's exercise of the option was $67.625. Thereafter the taxpayer sold the shares for $69.224 per share. In his income tax return for 1940 the taxpayer reported a short-term capital loss on the transaction, claiming that "cost or other basis" was $72.06 per share. The Commissioner disallowed the loss and determined a deficiency by changing the basis of the shares from $72.06 to $34.06 per share, the actual money paid the trustee for the shares. The Third Circuit affirmed the Tax Court in sustaining the Commissioner's determination, and the Supreme Court denied certiorari.

The taxpayer attempts to distinguish the *Mack* case on the ground that the power given the executor was discretionary and not mandatory. Under Wisconsin law (See 27 Wisconsin Statutes Annotated (1957), Section 232.23) the power given the executor is mandatory and not discretionary. The reasoning of the *Mack* case is therefore applicable.

It is clear under the facts and applicable authorities that the real property which the taxpayer sold in 1953 had not been previously "acquired by bequest, devise, or inheritance" within the meaning of Section 113 (a) (5) of the Internal Revenue Code of 1939, thus the District Court properly determined that in computing any gain or loss on the subsequent sale of the property the taxpayer's basis was cost, plus expenses of the sale and not the value at which the property was appraised in decedent's estate.

The judgment of the District Court is affirmed.

AFFIRMED.

UNITED STATES DISTRICT COURT.

Eastern District of Wisconsin.

Leslie J. Valleskey and Grace Valleskey, *Plaintiffs*, *vs.* E. J. Nelson, District Director of Internal Revenue, *Defendant.*	No. 58-C-14.

OPINION.

This action is based on a timely claim for refund, of $2,730.05 principal, and $529.25 interest, assessed and collected by the District Director of Internal Revenue as a deficiency in income tax due from plaintiffs for the year 1953.

The legal issues are before the court on motions for summary judgment by plaintiffs and by the defendant, the parties having stipulated all facts.

Plaintiffs are husband and wife who filed a joint tax return for the year 1953. Plaintiff Leslie J. Valleskey, hereinafter called the taxpayer, was the attorney for one Meta Michelson for a number of years. Said Meta Michelson died testate, March 15, 1953. Item 38 of her will is as follows:

> "I hereby authorize my executors hereinafter named to sell my home, located at 102½ South 15th Street, Manitowoc, Wisconsin, to Leslie J. Valleskey for the assessed valuation thereof as of 1950, if he desires to purchase the same for that amount."

The 1950 assessed value of the subject realty was $4,800. It was appraised at $10,250 in the estate. This figure

was used in the federal estate and state inheritance tax computations.

A schedule annexed to the Order Determining Inheritance Tax, issued by the County Court of Manitowoc County, Wisconsin, dated October 20, 1953, lists taxpayer as a legatee, standing in the relationship of stranger to the deceased, Meta Michelson, and a bequest to taxpayer in the amount of $5,456. Tax on the bequest was determined to be $620.98. This tax was paid by the East Wisconsin Trustee Company, the executor.

In the Claim for Refund, attached to the complaint in this action, taxpayer recites that he and the East Wisconsin Trustee Company were appointed as co-executors under the will of Meta Michelson. After getting assurance that taxpayer would get the Michelson home, pursuant to Item 38 of the will, taxpayer declined to serve as co-executor. He did act as attorney for the executor throughout the probate proceedings. The Michelson home was conveyed to taxpayer on May 27, 1953 on payment of $4,800.

On June 1, 1953, taxpayer sold the Michelson home for the sum of $10,000. In computing gain or loss in this transaction for federal income tax purposes, taxpayer used the sum of $10,290 as basis, consisting of the appraised value of $10,250 plus selling expenses in the amount of $40. The ultimate effect of using this amount as a basis resulted in a short-term capital loss of $290, and that was claimed by plaintiffs in their federal income tax return for the year 1953.

The Government concluded that the basis to be used was $4,840, consisting of the $4,800 which taxpayer paid for the property, plus $40, selling costs. This resulted in a short-term capital gain of $5,160. On this basis a deficiency assessment was made of $2,703.05, which plaintiffs paid.

together with interest in the amount of $529.25. Plaintiffs' timely claim for refund of these sums was refused.

The applicable statute is 26 U. S. C. A., Int. Rev. Code, 1939, as amended,

> "§ 113. Adjusted basis for determining gain or loss—
>
> "(a) Basis (unadjusted) of property. The basis of property shall be the cost of such property; except that— • • •
>
> "(5) Property transmitted at death.
>
> "If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition. • • • "

Taxpayer's argument may be briefly summarized. Item 38 of the will of Meta Michelson constitutes a conditional testamentary gift to the taxpayer. This provision created a special power of appointment with respect to the Michelson home. Under the special power, an interest in the realty passed directly from the donor of the power, the testatrix, at the time of her death, to the appointee, the taxpayer, to the extent of the gift, allegedly 52% of the value of the realty. Therefore, Section 113(a)(5) is applicable to give the appointee a basis of fair market value of the property at the time of the acquisition with respect to 52% of the Michelson home, which, when added to the amount paid by taxpayer, or $4,800 for the remaining 48% thereof, establishes a basis of $10,250.

He argues that even if the provision of the will should be construed as giving taxpayer an option to purchase the realty, such an option creates an interest in land under applicable Wisconsin law. Since the option was acquired by bequest, taxpayer acquired an interest in the property by bequest, and Section 113 (a) (5) is applicable. He urges that the probate court determined that taxpayer acquired

the property in question by inheritance. This determination is binding on the Government since local law controls as to determinations of property rights.

The Government contends that taxpayer acquired the property by purchase on exercising the option to purchase extended to him pursuant to the provisions of the will. The option did not confer an interest in the property upon taxpayer. Therefore, taxpayer acquired the realty by purchase and his basis is the cost of the property, or $4,800.

The issue to be determined is whether (a) the actual consideration paid, or (b) the fair market value at the time of death of the testatrix, is the basis for computing gain or loss on the subsequent sale by taxpayer of property acquired by him pursuant to a will authorizing the sale thereof by the executor to taxpayer for an amount substantially less than its fair market value.

Whether Section 113 (a) (5) applies in this case to provide a basis of "fair market value * * * at the time of * * * acquisition" depends on the nature of the interest in the Michelson home passing to taxpayer under Item 3 of the will.

Substantially similar language in testamentary provisions in other cases has been construed as creating options to purchase in the legatees.[1] One difference that may be

1. Cf. *Mack* v. *Commissioner of Internal Revenue*, 3 T. C. 390, 391 (1944), aff'd 148 F. 2d 62 (C. A. 3, 1945), cert. den. 326 U. S. 719.

> "I direct that my Trustees shall set aside Twenty Thousand (20,000) shares of my common capital stock of G. C. Murphy Company for the benefit of my sons, John Gordon Mack and James S. Mack, and the institutions hereinafter mentioned. At any time during the first ten (10) years after the date of my death my Trustees shall sell and deliver to my said sons said Twenty Thousand (20,000) shares and any stock dividends thereon, or such part thereof as they shall from time to time elect to purchase, at one-half (½) the average market price per share as hereinafter defined. * * *"

noted is that there is no time limit provided within which the sale is to occur in Item 38 of the will in question.

Taxpayer's contention that Item 38 creates a power of appointment, testatrix being the grantor, the executor, the grantee of the power, and taxpayer, the appointee, is well founded. The creation, construction and execution of powers are governed by statute in Wisconsin. (Wis. Stats. § 232.01)[2] A power is an authority to do some act in relation to lands, or the creation of estates therein. (Wis. Stats. § 232.02.)[3] The power in question here is a special power in trust. (Wis. Stats. § 232.06(1))[4] and (Wis. Stats.

Cadby v. Commissioner of Internal Revenue, 24 T. C. 899 (1955).

"'I hereby authorize, empower and direct my said executor and trustee to sell to W. Winne Cadby and Charles D. DeFreest the five hundred (500) shares of preferred stock and the two hundred and seventy (270) shares of common stock of Cadby & Son, Inc., now owned by me, upon the payment of Twenty-five thousand dollars ($25,000.00), provided satisfactory proof is given to my said executor and trustee that said persons have purchased from my said wife, Mabel A. Cadby, the sixty (60) shares of preferred stock of said corporation now owned by her and have paid to her the sum of Six thousand dollars ($6,000.00) therefor, and further provided that each of said purchases and payments shall have been made within two years from the date of my death. • • •"

2. Wis. Stats. § 232.01:

"How far abolished. Powers, except as authorized and provided for in this chapter, are abolished; and the creation, construction and execution of powers shall be governed by the provisions herein contained."

3. Wis. Stats. § 232.02:

"Definition. A power is an authority to do some act in relation to lands, or the creation of estates therein, or of charges thereon, which the owner granting or reserving such power might himself lawfully perform."

4. Wis. Stats. § 232.06(1):

"Special power. A power is special:

"(1) When the person or class of persons to whom the disposition of the lands under the power to be made are designated. • • •"

§ 232.22(1))[5] and its execution is therefore mandatory upon the grantee. (Wis. Stats. § 232.23.)[6]

The act in relation to lands which is the subject of the power, pursuant to Item 38 of the will, authorizes the executor to sell the home, for a determinable consideration, to the taxpayer. In legal effect, this is a bequest by the testatrix to taxpayer of the right to purchase her home for $4,800. This right was acquired by taxpayer on the death of the testatrix. It creates in taxpayer an equitable interest in the land insofar as he has an enforceable right to have the land conveyed to him on performance of the condition.

The right thus bequeathed to taxpayer was determined as having a value of $5,450 for purposes of computing Wisconsin Inheritance Tax thereon. Had taxpayer assigned or sold this right, his basis for computing gain or loss on the transaction would have been the fair market value thereof at the date of the death of the testatrix. *Helvering* v. *San Joaquin Co.*, 297 U. S. 496 (1935); *Cadha* v. *Commissioner of Internal Revenue*, 24 T. C. 899 (1955).

Testatrix did not devise the home itself to taxpayer under Item 38 of her will. Nor did she devise any portion thereof to him. The fact that a valuation, determined by computing the difference between the fair market value of the Michelson home at the time of testatrix's death and the amount of the payment to be made by taxpayer as

5. Wis. Stats. § 232.22(1):

"Special powers in trust. A special power is in trust

"(1) When the disposition which it authorizes is limited to be made to any particular persons other than the grantee of such power * * *"

6. Wis. Stats. § 232.23:

"Trust powers imperative. Every trust power, unless its execution or non-execution is made expressly to depend on the will of the grantee, is imperative and imposes a duty on the grantee the performance of which may be compelled by action for the benefit of the parties interested."

purchase price as a condition to the exercise of the power of appointment, has been placed on taxpayer's right to purchase cannot be equated as giving him a 52% interest in the home at the date of the death of the testatrix.

The value of the right to purchase is not in the nature of earnest money or a down-payment, to be treated as part of the consideration for the conveyance, unless that is the agreement between the parties. Nor is the creation of the right to purchase in the nature of a contract to purchase since the owner of the right is under no obligation to acquire the property and incurs no liability on failure to perform.

It would appear that taxpayer's rights under Item 38 of the will are in all essential respects similar to those of an optionee. Although having the right to purchase the property, and thereby having an equitable interest in land, the property itself was not acquired by bequest or by appointment, but on the exercise of the right to purchase, and therefore the property itself was transferred to taxpayer by virtue of the purchase. Section 113 (a)-(5) is therefore not applicable to establish a basis other than cost for this property.

A similar conclusion was reached by the court in *Mack* v. *Commissioner of Internal Revenue*, 148 F. 2d 62 (1945). Taxpayer contends that this case is distinguishable in that its rule is limited to options acquired by will, and that the *San Joaquin* case, *supra*, cited in *Mack*, as authority for the court's decision is not applicable in that it deals with an option contained in a lease and not acquired by bequest.

As noted above, the provisions of Item 38 of the will of Meta Michelson are substantially similar to those quoted in the opinion of the Tax Court in the *Mack* case. While the court there construes the provision as an option, and, here, almost identical language may be denominated a

power of appointment, in both instances the rights of the optionee or the appointee acquired by bequest are limited to the right to acquire property by purchase, and therefore different from the ownership of the asset itself.

The rule of the *San Joaquin* case is applicable here, as it was held controlling in *Mack*. There, taxpayer contended that having an option to buy realty for a period prior to the exercise thereof, gave him such an interest in the land that the appreciation of the land during the option period increased the value of the land, and increased the value of his option. On exercise of the option, for the agreed consideration, taxpayer added the claimed value of the option to the actual consideration paid, to establish a basis for computing gain or loss on a subsequent sale of this property. The court held that regardless whether taxpayer had an equitable interest in the property, namely, the right to purchase the property during the life of the option, he did not acquire the property until the exercise of the option, and that his basis therefore was the actual consideration paid and the cost of certain improvements of the land.

Taxpayer, here, wishes to add to the actual consideration paid for the Michelson home, the value of his rights to purchase this asset, to establish his basis. With respect to this contention, the rule of *San Joaquin* is controlling. The court believes that—

> "* * * The capital asset, sale of which resulted in taxable gain, was the land. This was not an asset of the taxpayer prior to the exercise of the option. We think it clear that there was no combination of two capital assets,—the option and $200,000 of cash, to form a new capital asset, the land, which was subsequently sold at a profit." *Helvering v. San Joaquin Co., supra* (p. 500).

The opinion of the Tax Court in the *Mack* case, 3 T. C. 390, aff'd in 148 F. 2d 62, contains language pertinent to the issue here. As seen from the quoted provision of the will, the trustees were directed to sell taxpayer certain shares of stock at approximately one-half of market value. Taxpayer used fair market value at death of testator as basis in a later sale of the property and arrived at a paper loss on the transaction.

> "What the petitioner acquired under the will of his father was an option to purchase * * *. The petitioner contends that that option had a value. * * *. What the petitioner sold here was not the option to purchase. That was personal to the petitioner. It could not be transferred. What he did sell was the five shares of stock which he purchased on November 25, 1940 * * *.
>
> "It seems plain that by reason of the purchase and sale of the five shares in 1940 the petitioner realized a gain of $175.82. Surely his bank account would reflect the increase.
>
> "In the light of these facts its seems decidedly unrealistic for the petitioner to claim that he had a loss from the transaction. The loss can be computed only by adding to the cost basis an assumed value for the option to purchase, which was, of course, exhausted in part by the purchase of the five shares * * *. We do not think, however, that the statute [Sec. 113(a)(5),] warrants such an assumption."
>
> *Mack* v. *Commissioner of Internal Revenue*, 3 T. C. 390, 395.

Taxpayer cites the rule of *Brewster* v. *Gage*, 280 U. S. 327 which concerned the date of acquisition of property bequeathed to a residuary legatee to the effect that the requirements of Section 113 (a) (5) are met when taxpayer has some interest in the property even though the interest may be contingent or conditional, and possession and control are deferred to some later time. This rule would benefit taxpayer had there been a bequest or appointment

of the property itself, absolute or contingent, under the will. But the bequest was not of the property itself, but of a conditional right to purchase the property.

As was said in *A. H. Morse Co. v. Commissioner of Internal Revenue*, 208 F. 2d 751, 756 (C. A. 1, 1953):

> "* * * It has been held that property is not 'acquired', within the meaning of previous revenue acts and the Internal Revenue Code, even when one has the *right* to obtain property such as under an option." (Citing *San Joaquin* and *Mack* cases.)

It may be noted that the record in this case does not indicate a County Court of Manitowoc County determination that taxpayer acquired the Michelson home by inheritance. As stated above, taxpayer is listed as a legatee, and the amount of the bequest is stated as $5,450. The subject-matter of the bequest is not further identified. There is nothing inconsistent in that order with the conclusion that taxpayer is a legatee of a bequest of a right to purchase certain property which for Wisconsin Inheritance Tax computations was valued at $5,450.

Taxpayer having acquired by bequest an interest in the Michelson home only to the extent of a right to purchase this home, this property was acquired by taxpayer by purchase, not by bequest. It follows, that his basis for computing gain or loss on a subsequent sale thereof is cost plus certain selling expenses under Section 113 (a).

Plaintiffs' motion for judgment is hereby denied, and the motion of defendant granted. Defendant's counsel is directed to prepare order for judgment and judgment in conformity herewith, submitting them to plaintiffs' counsel for approval as to form only.

Dated, Milwaukee, Wisconsin, this 12th day of December, 1958.

K. P. Gruber,
U. S. District Judge.

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JAMES R. BROWNING, Clerk

No. 588

In the Supreme Court of the United States

OCTOBER TERM, 1959

LESLIE J. VALLESKEY and GRACE VALLESKEY, *Petitioners*

v.

E. J. NELSON, DISTRICT DIRECTOR OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

---

BRIEF FOR THE RESPONDENT IN OPPOSITION

J. LEE RANKIN,
Solicitor General,

HOWARD A. HEFFRON,
Acting Assistant Attorney General,

ROBERT N. ANDERSON,
CAROLYN R. JUST,
Attorneys,
Department of Justice,
Washington 25, D. C.

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OPINIONS BELOW

The opinion of the District Court (Pet. 15-24) is reported at 168 F. Supp. 636. The opinion of the Court of Appeals (Pet. 11-14) is reported at 271 F. 2d 6.

JURISDICTION

The judgment of the Court of Appeals was entered on October 22, 1959. The petition for a writ of certiorari was filed on December 14, 1959. The jurisdic-

tion of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTION PRESENTED

Taxpayer acquired certain real property pursuant to a deceased client's will authorizing her executor to sell him such property at its 1950 assessed valuation if he desired to purchase it. The question is whether taxpayer acquired the property by bequest, devise or inheritance so as to entitle him to a basis under Section 113(a)(5) of the 1939 Code equal to its fair market value as of the client's death, or whether taxpayer's basis is the cost to him of the property.

STATUTES INVOLVED

The revelant portions of Section 113(a)(5) of the Internal Revenue Code of 1939 and Sections 231.12, 232.01, 232.02, 232.06(1), 232.22(1) and 232.23 of 27 West's Wisconsin Statutes Annotated (1957) are set forth in the Appendix, *infra*, pp. 8-9.

STATEMENT

The taxpayer, who with his wife resides in Manitowoc, Wisconsin, was the attorney for Meta Michelsons for a number of years preceding her death on March 15, 1953. Item 38 of her will provides as follows (R. 1[1]):

> I hereby authorize my executors hereinafter named to sell my home, located at 1026 South 15th Street, Manitowoc, Wisconsin, to Leslie J. Valleskey for the assessed valuation thereof as of 1950, if he desires to purchase the same for that amount.

[1] Record references are to the appendix to the taxpayer's brief in the Court of Appeals.

Taxpayer and the East Wisconsin Trustee Company were appointed as co-executors under the will. After assurance that he would get the Michelson home pursuant to Item 38 of the will, the taxpayer declined to serve as co-executor, although he did act as attorney for the executor throughout the probate proceedings. (R. 2.)

The assessed value of the Michelson property in 1950 was $4,800. It was appraised at $10,250 in the estate, which amount was used in the federal estate and state inheritance tax computations. The property was conveyed to taxpayer on May 27, 1953, on payment of $4,800. On June 1, 1953, taxpayer sold the property for $10,000, the expenses of sale being $40. (R. 1-2.)

A schedule annexed to the Order Determining Inheritance Tax issued by the County Court of Manitowoc County, Wisconsin, dated October 20, 1953, lists the taxpayer as a legatee, standing in the relationship of stranger to the deceased, Meta Michelson, and a bequest to taxpayer in the amount of $5,450. Tax on the bequest was determined to be $620.98. This tax was paid by the East Wisconsin Trustee Company, the executor. (R. 2.)

In computing gain or loss on the resale of the property for federal income tax purposes, the taxpayer used $10,290 as the basis, consisting of the appraised value at the date of his former client's death, plus selling expenses, and he reported a short-term capital loss of $290 in his income tax return for 1953. Thereafter, the Government concluded that the basis should have been $4,840, or the amount the taxpayer paid for the property plus expenses of sale, which would result in a short-term capital gain of $5,160. A deficiency assessment was made in the amount of $2,703.03, which

the taxpayer paid together with interest of $529.25. The taxpayer filed a timely claim for refund which was denied. (R. 2.)

The District Court entered an order and judgment dismissing the taxpayer's suit for refund. (R. 11.) The Court of Appeals affirmed, holding that inasmuch as the real property which the taxpayer sold in 1953 had not been acquired by him "by bequest, devise, or inheritance" within the meaning of Section 113(a)(5) of the Internal Revenue Code of 1939, Appendix, *infra*, p. 8, the taxpayer's basis for determining gain or loss on the resale was the cost to him of such property, plus expenses of sale, and not the value at which the property was appraised in the decedent's estate.

ARGUMENT

The taxpayer contends (Pet. 6-10) that he acquired the real property directly from Meta Michelson as a contingent testamentary gift, and, therefore, that the exception set forth in subsection (5) of Section 113(a) of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 8)—that if property is acquired by bequest, devise, or inheritance, its basis, for the purpose of determining gain or loss upon its subsequent resale, shall be the fair market value at the time the property is acquired—is applicable. This contention, however, is at variance with the facts of record and has been rejected by the courts below, which have both agreed that there was no gift of any portion of the property itself to the taxpayer under the terms of the will and that the transaction did not fall within the provisions of Section 113(a)(5). (Pet. 14, 21.) As pointed out by the Court of Appeals, Item 38 of the will, which

uses the phrases "to sell" and "to purchase", means only that the taxpayer was accorded the right to purchase the property. The court also noted that under Wisconsin law, 27 West's Wisconsin Statutes Annotated (1957), Section 232.23, the power given the executor under the will is mandatory and that the wording of Item 38 shows that the testatrix intended to bind her executors to sell the property to the taxpayer if he wanted to buy. (Pet. 13, 14.)

The resolution of the issue presented depends upon the construction to be given the particular language of Mrs. Michelson's will and upon the interpretation and application of the pertinent provisions of Wisconsin law. It is obvious, therefore, that the issue is not one of general importance. Moreover, this Court will not ordinarily review a determination of local law made by a court of appeals. *Rajan* v. *Merchants Transfer Co.*, 337 U.S. 530, 534.

The decisions below are not in conflict with *Augustus* v. *Commissioner*, 118 F. 2d 38 (C.A. 6th) as asserted by the taxpayer. (Pet. 6-8.) In the *Augustus* case, the taxpayer acquired a contingent reversionary interest by virtue of her father's will, the mother having a right to consume the property with power to dispose of one-half of what remained by will at her death and the father's will providing that the testator gave, devised, and bequeathed the other half of the trust fund to his legal heirs and assigns forever. The issue there was whether the basis of the securities which the taxpayer acquired from the trust at her mother's death in 1928 (which she sold in 1935 and 1936) was their value in 1928, at the mother's death, or in 1922, when her father died. It was held that Section 113(a)(5) of the 1939 Code applied to contingent as well as vested remain-

ders, and, therefore, that the taxpayer's basis under subsection (5) was the value of the securities in 1922. The instant case is distinguishable inasmuch as the taxpayer did not acquire the property in question by bequest, devise or inheritance, but, rather, by purchase. Subsection 5, therefore, is inapplicable, and, under the general statutory rule, the taxpayer's basis is the cost of the property.

The decisions below are in accord with the rationale of this Court's opinion in *Helvering* v. *San Joaquin Co.*, 297 U.S. 496, which sustained the Commissioner's determination that a lessee first acquired the land there involved on November 3, 1916, upon the exercise of an option to purchase granted in a ten-year lease executed in 1906. This Court held that the basis of the property was the actual amount paid for the land in 1916 and not a larger figure contended for by the lessee on the theory that it had acquired an interest in the land when the lease was executed.

The Third Circuit relied on the *San Joaquin Co.* case, *supra*, in *Mack* v. *Commissioner*, 148 F. 2d 62, certiorari denied, 326 U.S. 719, in which the facts, as the courts below noted, are substantially similar to those in the instant case. (Pet. 13-14, 21-23.) In the *Mack* case, the taxpayer acquired, under his father's will, an option to purchase a limited number of shares of stock from the testamentary trustee at a price equal to one-half of the average market value of the shares at the time of the exercise of the option, and the Third Circuit held that the taxpayer's basis was the actual amount paid the trustee for the shares.

CONCLUSION

The decision below is correct and no conflict of decisions is involved. The petition for a writ of certiorari should be denied.

Respectfully submitted,

J. LEE RANKIN,
Solicitor General,

HOWARD A. HEFFRON,
Acting Assistant Attorney General,

ROBERT N. ANDERSON,
CAROLYN R. JUST,
Attorneys.

January, 1960.

APPENDIX

Internal Revenue Code of 1939:

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(5) *Property transmitted at death.*—If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition. * * *

* * * * *

(26 U.S.C., 1952 ed., Sec. 113.)

27 Wisconsin Statutes Annotated (1957):

TITLE XX. REAL PROPERTY, AND THE NATURE AND QUALITIES OF ESTATES THEREIN

Chapter 231. Uses and Trusts.

Sec. 231.12 *Devises as powers*

A devise of land to executors or other trustees to be sold or mortgaged, where such trustees are not also empowered to receive the rents and profits, shall vest no estate in the trustees; but the trust shall be valid as a power and the lands shall descend to the heirs or pass to the devisees of the testator subject to the execution of the power.

Chapter 232. Powers.

Sec. 232.01 *How far abolished*

Powers, except as authorized and provided for in this chapter, are abolished; and the creation

construction and execution of powers shall be governed by the provisions herein contained."

Sec. 232.02. *Definition.*

A power is an authority to do some act in relation to lands, or the creation of estates therein, or of charges thereon, which the owner granting or reserving such power might himself lawfully perform.

Sec. 232.06 *Special power.*

A power is special:

(1) When the person or class of persons to whom the disposition of the lands under the power to be made are designated.

* * * * *

Sec. 232.22 *Special powers in trust.*

A special power is in trust:

(1) When the disposition which it authorizes is limited to be made to any particular persons other than the grantee of such power.

* * * * *

Sec. 232.23 *Trust powers imperative.*

Every trust power, unless its execution or non-execution is made expressly to depend on the will of the grantee, is imperative and imposes a duty on the grantee the performance of which may be compelled by action for the benefit of the parties interested.

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